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Baseline Forecast of GRF Revenues and Medicaid Expenditures for the FY 2014-FY 2015 Biennial Budget

Testimony before the Senate Finance Committee

April 16, 2013

Chairman Oelslager and members of the Senate Finance Committee, I am Mark Flanders, Director of the Legislative Service Commission (LSC). I am here to testify on LSC's forecasts for General Revenue Fund (GRF) revenues and Medicaid expenditures in fiscal years 2013 through 2015. The information in the accompanying LSC forecast book includes an overview and forecast for the economy, forecasts of GRF revenues, and forecasts of expenditures in the Medicaid Program. These are baseline forecasts, LSC's predictions for revenues and expenditures if current law were to remain unchanged throughout the next biennium.

Summary – Comparison of LSC and Executive Budget Baseline Forecasts

LSC forecasts somewhat higher baseline GRF revenues for the biennium than are forecast for the executive budget. The forecast is higher in both of the fiscal years.

The differences between LSC's forecasts of total GRF receipts and those in the executive budget are summarized in the table below. The differences in this testimony are presented as LSC's forecast minus the executive's, so a positive number corresponds to LSC forecasting higher revenue. LSC's forecast for the biennium is $293.2 million higher than the Office of Budget and Management's (OBM's). Three tables that are attached to this testimony provide more detailed forecast comparisons for fiscal years 2013 through 2015.

Summary of LSC and OBM Baseline GRF Revenue Forecast Differences

	FY 2013	FY 2014	FY 2015
Dollar Difference	$77.1 million	$85.4 million	$207.8 million
Percent Difference	0.3%	0.3%	0.6%

LSC forecasts baseline Medicaid service expenditures to be lower for FY 2013, FY 2014, and FY 2015 than are forecast in the executive budget. The differences between LSC's forecasts of Medicaid service expenditures and those in the executive budget are summarized in the table below.

Summary of LSC and OBM Baseline All-Fund Medicaid Forecast Differences

	FY 2013	FY 2014	FY 2015
Dollar Difference	-$52.0 million	-$119.1 million	-$80.7 million
State Share	-$18.8 million	-$41.2 million	-$28.2 million
Percent Difference	0.3%	0.6%	0.4%

Tax revenues and Medicaid service expenditures are heavily dependent on developments in the economy. In the rest of my testimony, I will focus on these topics, starting with the economy.

The Economy

The LSC forecasts are based on an economic forecast produced in January. Since then, there have been a number of developments that could be expected to affect the outlook for the U.S. economy. U.S. inflation-adjusted gross domestic product (real GDP), initially estimated to have decreased by 0.1% in the fourth quarter of calendar year 2012, is now estimated to have grown by 0.4%. The weak growth was due to transitory factors, such as reduced inventory accumulation and a decline in federal spending on national defense. On the positive side, consumer spending grew by 1.8% for the quarter, slightly faster than during the preceding two quarters.

In addition to the weak fourth quarter growth, the federal government's spending sequestration is now a reality. Sequestration, in this case, refers to a drop in federal spending by $85 billion this federal fiscal year, with larger reductions (about $109 billion per year) in future fiscal years. Sequestration was required to begin March 1, with half the spending cuts required to be taken from defense spending and half from other programs. The Congressional Budget Office (CBO) projected in February that the combined effects of certain fiscal tightening moves, specifically (1) sequestration, (2) the end of a temporary 2% payroll tax reduction for Social Security, and (3) higher marginal income tax rates for higher income taxpayers, would reduce growth in real GDP by about 1.25 percentage points in 2013. CBO projected that sequestration would account for about half of this reduction; Global Insight, a private economic forecasting firm, projects a drag of 0.4 percentage points, but that is based on their expectation that sequestration will last only until around September 30. As expected, there has been little sign as yet of a macroeconomic effect of sequestration, but the effects are expected to build in the coming months. And, in addition to the macroeconomic effects, sequestration will have a direct effect on the state budget. I should note, though, that the Medicaid Program was specifically exempted from any cuts under sequestration.

In spite of these developments most recent indicators have implied continued slow economic growth. Because that growth has been slow, large numbers of people are still unemployed, both nationally and in Ohio. National payroll employment grew by 1.5% during the year ending in February; for Ohio the comparable figure is 0.6%, representing an increase of slightly over 33,000 jobs. Most of Ohio's economic sectors experienced job gains for the year, though employment in government contracted; Ohio's private sector employment grew by nearly 45,000 for the year. Ohio's unemployment rate has declined slowly, from a high of 10.6% in late 2009 and early 2010, to 7.0% in February. Though the number of unemployed Ohio workers declined by nearly 224,000 from January 2010 to February 2013, it should be noted that just 86,000 (39%) of the decline was due to workers finding jobs; the rest was due to workers exiting the labor force. It may also be worth noting that the unemployment rate was lower, at 6.7%, in December, the most recent data available when I testified before House Finance.

The LSC forecasts are based on continuation of the economic expansion, though economic forecasters point to a number of risks to that continuation. In addition to the sequestration issue discussed above, there are other risks posed by federal fiscal policy. Congress did raise the national debt ceiling recently, allowing the U.S. Treasury to continue to borrow (for purposes other than refinancing bonds previously issued), but the debt ceiling is projected to become an issue again in late summer. Other risks include continuing economic and financial problems in Europe, which could lead to reductions in U.S. exports, and, seemingly as always, oil prices. Tension in the Middle East, perhaps centered on Iran, could lead to a sharp increase in oil prices despite the growth in supply arising domestically. Some analysts foresee problems in financial markets arising from borrowers' difficulties in repaying student loan debt. Other adverse developments, not currently foreseen, could undermine the economic outlook.

As you consider the forecasts below, then, please remember that it is inevitable that economic forecasts are very uncertain things. The only thing that we know for certain is that forecasts will be wrong; it is only a question of how much and in which direction. It is possible that the baseline forecast could prove significantly too optimistic regarding economic growth in the nation and Ohio. Alternatively, it could be that it will prove to be too pessimistic.

In developing a GRF revenue forecast, LSC economists relied on Global Insight for the economic predictions that underlie those revenue forecasts. Specifically (as noted above), we used Global Insight's January baseline forecasts for the nation and Ohio as the sources for input or explanatory variables in the models.

As is detailed in the accompanying forecast materials, this forecast shows national real GDP, the broadest measure of economic activity, growing at about a 2.0% annual rate during the period corresponding to state FY 2013, by 2.1% during FY 2014, and by 3.2% during FY 2015. Personal income in Ohio, which is not adjusted for inflation, is forecast to grow somewhat faster, by 3.5% during the current fiscal year and during FY 2014, and by 4.4% during FY 2015. These growth rates are strong enough to bring down unemployment, but only slowly. By the end of FY 2015, Ohio's statewide average unemployment rate is projected to fall only to 6.5%, from the 6.8% level expected for the current quarter.

Revenue Forecasts

The LSC baseline forecasts for FY 2014 and FY 2015 assume the current Revised Code tax structure. Among the notable implications of that is that the newly enacted financial institutions tax (FIT) begins to generate revenue in FY 2014, and the taxes that it is replacing, the corporate franchise tax and the business and property tax, are expected to produce no revenue during the upcoming biennium. The estate tax, which no longer applies to estates of individuals who died after the first of this year, is expected to yield little revenue in FY 2014 (and none in FY 2015). Also, the GRF is assumed not to receive an amount, estimated to be $140 million per year, of commercial activity tax (CAT) revenue attributable to sales of petroleum products, in accordance with an Ohio Supreme Court decision handed down in December. Finally, 1.68% of GRF tax receipts are forecast to be transferred to the Local Government Fund (LGF) and 1.69% to the Public Library Fund (PLF) starting in FY 2014, based on the LSC estimate of tax receipts for FY 2013.

For FY 2013, LSC estimates total GRF tax revenue to be $20.71 billion, after distributions to the local government funds. This is $107 million more than the current estimate by OBM. LSC estimates that this expected positive variance in revenues will be augmented slightly by earnings on investments, which combined with revenues from license fees are estimated to be $3 million above the OBM estimate.

For FY 2014, LSC forecasts total GRF tax revenue to be $21.23 billion, a $523 million (2.5%) increase from FY 2013. Economic growth forecast by Global Insight is expected to lead to moderate growth in most tax sources. Income tax revenue is forecast to grow by 2.0% due to improved labor markets, proprietors' income, and income from investments. The growth is restrained due to an assumption that some revenue realized in FY 2013 was due to one-time payments intended to avoid increases in federal income tax rates that, as of late last year, were to have gone into effect on January 1. Revenue is expected to increase strongly from the nonauto sales and use tax, primarily due to increasing revenue from Medicaid health insuring corporations (HICs). A projected decline in cigarette tax revenue is due to the continuation of a long-term trend. A projected decline in revenue from the kilowatt hour tax is due to weak growth in all funds revenue being more than offset by growing allocations to the PLF, which are debited in part against this tax.

For FY 2015, LSC forecasts total GRF tax revenue to increase to $22.30 billion, representing growth of $1.07 billion (5.0%) from FY 2014. Revenue growth is forecast to continue for most taxes, again with the notable exception of the cigarette tax.

Medicaid Expenditure Forecast

All Medicaid figures that I am presenting are "all funds," also referred to as combined state and federal dollars. For FY 2013, Medicaid expenditures are projected to be $16.33 billion. For FY 2014, Medicaid expenditures are estimated to be $18.84 billion, a $2.51 billion (15.3%) increase from FY 2013. For FY 2015, Medicaid expenditures are projected to be $19.71 billion, an $872 million (4.6%) increase from FY 2014. As indicated earlier, these estimates are lower than OBM estimates by $119.1 million (0.6%) in FY 2014 and by $80.7 million (0.4%) in FY 2015.

The projected 15.3% increase in Medicaid expenditures from FY 2013 to FY 2014 is due to a few factors, one factor being the "woodwork effect" resulting from the Affordable Care Act (ACA). The term "woodwork effect" references the projected increase in Medicaid caseloads of individuals who are currently eligible for Medicaid but not enrolled. Because of the publicity and heightened awareness of coverage requirements and opportunities under the ACA, many of these individuals may apply for coverage, even if the state does not implement the optional Medicaid expansion.

Another factor is the physician rate increase required under the ACA. Under this requirement, states must raise Medicaid physician fees to at least Medicare levels for family physicians, internists, and pediatricians for many primary care services. This rate increase applies in calendar years 2013 and 2014, is fully federally funded, and therefore increases the amount of projected federal Medicaid dollars the state is expected to receive.

Another factor that affects the projected increase in Medicaid expenditures is the expanded services that will be provided to certain Medicaid enrollees through the Integrated Care Delivery System (ICDS) and through Health Homes. Under ICDS, Ohio will provide an estimated 115,000 Medicare and Medicaid dual enrollees in seven regions (29 counties) in the state with more coordinated, person-centered care through comprehensive assessments of their medical, behavioral health, long-term care services and supports, and social needs. Through the implementation of health homes, Ohio will provide greater care coordination for individuals with serious and persistent mental illness.

The last factor affecting projected Medicaid expenditures in FY 2014 is the projected increases in aged, blind, and disabled (ABD) caseloads as well as increases in ABD monthly per member costs. Due to Ohio's aging population, the increase in ABD caseloads is projected to more than offset the decrease in caseloads of families and children that is expected due to economic growth.

The projected 4.6% increase in Medicaid expenditures from FY 2014 to FY 2015 is due to the continuation of the factors listed above, particularly the projected increase in ABD caseloads and monthly per member costs.

Mr. Chairman and members of the Committee, thank you for the opportunity to present the LSC forecasts. My staff and I would be happy to answer any questions that you may have.

Forecast Testimony-Senate.docx/

FY 2013 Revenue Estimates Millions of Dollars						
GRF	**Original Aug. 2012**	**OBM Jan. 2013**	**Change**	**LSC Jan. 2013**	**Change**	**LSC Minus OBM**
TAX REVENUE						
Auto Sales	$1,075.0	$1,070.0	-$5.0	$1,080.6	$5.6	$10.6
Nonauto Sales & Use	$7,350.0	$7,297.9	-$52.1	$7,315.4	-$34.6	$17.5
Total Sales & Use Taxes	$8,425.0	$8,367.9	-$57.1	$8,396.0	-$29.0	$28.1
Personal Income	$8,970.0	$9,250.5	$280.5	$9,263.1	$293.1	$12.6
Commercial Activity	$850.0	$831.4	-$18.6	$842.7	-$7.3	$11.3
Corporate Franchise	$150.0	$180.0	$30.0	$201.7	$51.7	$21.7
Financial Institutions						
Public Utility	$115.0	$110.0	-$5.0	$116.4	$1.4	$6.4
Kilowatt Hour Excise	$305.0	$296.9	-$8.1	$298.9	-$6.1	$2.0
Natural Gas Consumption (MCF)	$60.0	$60.0	$0.0	$58.3	-$1.7	-$1.7
Foreign Insurance	$270.0	$270.0	$0.0	$279.0	$9.0	$9.0
Domestic Insurance	$195.0	$200.0	$5.0	$206.0	$11.0	$6.0
Business & Property	$25.0	$25.0	$0.0	$25.0	$0.0	$0.0
Cigarette	$815.0	$815.0	$0.0	$820.8	$5.8	$5.8
Alcoholic Beverage	$58.0	$58.0	$0.0	$58.3	$0.3	$0.3
Liquor Gallonage	$40.0	$40.0	$0.0	$40.1	$0.1	$0.1
Estate	$66.0	$100.0	$34.0	$105.6	$39.6	$5.6
Total Tax Revenue	$20,344.0	$20,604.6	$260.7	$20,711.8	$367.9	$107.2
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$5.5	$5.5	$0.0	$7.5	$2.0	$2.0
Licenses and Fees	$46.0	$46.0	$0.0	$47.0	$1.0	$1.0
Other Revenue	$48.0	$48.0	$0.0	$48.0	$0.0	$0.0
Nontax State-Source Revenue	$99.5	$99.5	$0.0	$102.5	$3.0	$3.0
Federal Grants	$8,151.3	$7,608.6	-$542.7	$7,575.4	-$575.9	-$33.2
TOTAL GRF SOURCE DIFFERENCE						**$77.1**

FY 2014 Baseline Revenue Forecasts Millions of Dollars						
GRF			**LSC Minus OBM**		**Growth from FY 2013**	
	OBM	**LSC**	**Difference**	**Percent**	**OBM**	**LSC**
TAX REVENUE						
Auto Sales	$1,119.0	$1,128.0	$9.0	0.8%	4.6%	4.4%
Nonauto Sales & Use	$7,802.1	$7,766.2	-$35.9	-0.5%	6.9%	6.2%
Total Sales & Use Taxes	$8,921.1	$8,894.2	-$26.9	-0.3%	6.6%	5.9%
Personal Income	$9,335.7	$9,448.7	$113.0	1.2%	0.9%	2.0%
Commercial Activity	$795.1	$793.8	-$1.3	-0.2%	-4.4%	-5.8%
Corporate Franchise	$0.0	$0.0	$0.0	--	-100.0%	-100.0%
Financial Institutions	$190.0	$200.0	$10.0	5.3%	--	--
Public Utility	$110.0	$125.6	$15.6	14.2%	0.0%	7.9%
Kilowatt Hour Excise	$279.1	$289.2	$10.1	3.6%	-6.0%	-3.2%
Natural Gas Consumption (MCF)	$60.0	$60.4	$0.4	0.7%	0.0%	3.6%
Foreign Insurance	$272.0	$288.0	$16.0	5.9%	0.7%	3.2%
Domestic Insurance	$214.0	$211.0	-$3.0	-1.4%	7.0%	2.4%
Business & Property	$0.0	$0.0	$0.0	--	-100.0%	-100.0%
Cigarette	$790.0	$799.2	$9.2	1.2%	-3.1%	-2.6%
Alcoholic Beverage	$58.0	$60.7	$2.7	4.7%	0.0%	4.1%
Liquor Gallonage	$41.4	$41.0	-$0.4	-1.0%	3.5%	2.2%
Estate	$15.0	$23.0	$8.0	53.3%	-85.0%	-78.2%
Total Tax Revenue	$21,081.4	$21,234.8	$153.4	0.7%	2.3%	2.5%
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$6.0	$8.4	$2.4	40.0%	9.1%	12.0%
Licenses and Fees	$46.0	$48.6	$2.6	5.7%	0.0%	3.4%
Other Revenue	$43.0	$47.9	$4.9	11.4%	-10.4%	-0.2%
Nontax State-Source Revenue	$95.0	$104.9	$9.9	10.4%	-4.5%	2.3%
Federal Grants	$9,423.3	$9,345.4	-$77.9	-0.8%	23.9%	23.4%
TOTAL GRF SOURCE DIFFERENCE			**$85.4**	**0.3%**		

FY 2015 Baseline Revenue Forecasts Millions of Dollars						
GRF	OBM	LSC	LSC Minus OBM Difference	LSC Minus OBM Percent	Growth from FY 2014 OBM	Growth from FY 2014 LSC
TAX REVENUE						
Auto Sales	$1,172.0	$1,179.0	$7.0	0.6%	4.7%	4.5%
Nonauto Sales & Use	$8,261.5	$8,224.5	-$37.0	-0.4%	5.9%	5.9%
Total Sales & Use Taxes	$9,433.5	$9,403.5	-$30.0	-0.3%	5.7%	5.7%
Personal Income	$9,760.3	$9,951.7	$191.4	2.0%	4.5%	5.3%
Commercial Activity	$820.9	$826.9	$6.0	0.7%	3.2%	4.2%
Corporate Franchise	$0.0	$0.0	$0.0	--	--	--
Financial Institutions	$200.0	$209.0	$9.0	4.5%	5.3%	4.5%
Public Utility	$110.0	$138.6	$28.6	26.0%	0.0%	10.4%
Kilowatt Hour Excise	$270.5	$282.0	$11.5	4.3%	-3.1%	-2.5%
Natural Gas Consumption (MCF)	$60.0	$62.4	$2.4	4.0%	0.0%	3.3%
Foreign Insurance	$276.0	$299.0	$23.0	8.3%	1.5%	3.8%
Domestic Insurance	$254.0	$247.0	-$7.0	-2.8%	18.7%	17.1%
Business & Property	$0.0	$0.0	$0.0	--	--	--
Cigarette	$765.0	$778.3	$13.3	1.7%	-3.2%	-2.6%
Alcoholic Beverage	$58.0	$61.0	$3.0	5.2%	0.0%	0.5%
Liquor Gallonage	$42.5	$41.9	-$0.6	-1.4%	2.7%	2.2%
Estate	$0.0	$0.0	$0.0	--	-100.0%	-100.0%
Total Tax Revenue	$22,050.6	$22,301.1	$250.5	1.1%	4.6%	5.0%
NONTAX STATE-SOURCE REVENUE						
Earnings on Investments	$6.0	$11.3	$5.3	88.3%	0.0%	34.5%
Licenses and Fees	$46.0	$50.5	$4.5	9.8%	0.0%	3.9%
Other Revenue	$51.2	$51.2	$0.0	0.0%	19.1%	6.9%
Nontax State-Source Revenue	$103.2	$113.0	$9.8	9.5%	8.6%	7.7%
Federal Grants	$10,982.1	$10,929.6	-$52.5	-0.5%	16.5%	17.0%
TOTAL GRF SOURCE DIFFRENCE			**$207.8**	**0.6%**		